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No. 98-484

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

REBEL OIL COMPANY,
a Nevada corporation, and
AUTO FLITE OIL COMPANY, INC.,
a Nevada corporation,
Petitioners,

v.

ATLANTIC RICHFIELD COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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45 pp

QUESTION PRESENTED

Respondent Atlantic Richfield Company ("ARCO") disagrees with the petition's statement of the question presented for review. The question should be stated as follows:

> Did the court correctly affirm summary judgment as to petitioners' primary-line price-discrimination claim under Section 2(a) of the Robinson-Patman Act, based on petitioners' failure to present any evidence that the low gasoline prices of which they complained were below any measure of ARCO's cost?

PARTIES TO THE PROCEEDING

The caption of the petition correctly identifies the parties.

Pursuant to Supreme Court Rule 29.6, ARCO states that it has no parent company. The following are the nonwholly-owned subsidiaries or affiliates of ARCO:

85819 Canada Limited
Agro Internacional, S. de R. L. de C.V.
Alyeska Pipeline Service Company
AM/PM Japan Co. Ltd.
ARCO Solar Nigeria Ltd.
Badger Pipeline Company
Blair Athol Coal Pty., Limited
Clermont Coal Mines Limited
Colonial Pipeline Company
Compania de Petroleo Ganso Azul, Ltda.
Cook Inlet Pipe Line Company
Dalrymple Bay Coal Terminal Pty., Ltd.
Dixie Pipeline Company
East Heidelberg Salt Water Disposal Co.
East Texas Salt Water Disposal Co.
Jiu Feng ARCO Shipping Company, Ltd.
JSC Oil Company LUKoil
Kuparuk Transportation Capital Corp.
Kuparuk Transportation Company
Logan Aluminum Inc.
LUKARCO B.V.
New Cure, Inc.
Olympic Pipe Line Company
Prince William Sound Oil Spill Response Corporation
Streamelec B.V.
Texas-New Mexico Pipe Line Company
Vastar Resources, Inc.
Zhenhai Refining & Chemical Company Limited

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Sherman Act, Sections 1 and 2, 15 U.S.C. §§ 1,2 ..... 2, 12

Other:

III P. Areeda & H. Hovencamp, *Antitrust Law* (Rev. Ed. 1996) 5, 10
K. Case & L. Fair, *Principles of Microeconomics* (5th ed. 1999) 12

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RESPONDENT'S BRIEF IN OPPOSITION

STATEMENT OF THE CASE

The petition's statement of the case omits the procedural history of the case as necessary to a presentation of the issue decided below and misstates the record.

The case was filed by petitioners Rebel Oil Company and Auto Flite Oil Company, Inc.,[1] in January, 1990.

[1] Petitioners are related companies, under common ownership, and were treated for most purposes as a single entity, "Rebel", during proceedings in the courts below. Petitioners were, and are, gasoline marketers in Las Vegas, purchasing gasoline at wholesale from major and independent refiners, and selling gasoline both in the wholesale market, to smaller resellers and to commercial and industrial end-users, and in the retail market (*i.e.*, to motorists).

Petitioners alleged that ARCO's wholesale prices to its "ARCO"-branded retail dealers in Las Vegas were unreasonably low and were motivated by a desire to eliminate petitioners and other firms (including major-brand marketers such as Chevron, Texaco, Shell and Mobil) from the market. App. 3a-4a. The district court granted summary judgment to ARCO on the federal antitrust claims based on the absence of evidence of market power. App. 4a-5a.

On appeal from that ruling, the Ninth Circuit affirmed summary judgment on two of the three antitrust-law counts. App. 5a. While finding in ARCO's favor as to the claims under Sections 1 and 2 of the Sherman Act, the panel reversed the grant of summary judgment as to the claim of primary-line price discrimination under the Robinson-Patman Act. App. 5a. The panel held that even though ARCO's market share was insufficient to threaten monopolization, summary judgment could not be awarded on the price-discrimination claim because petitioners might be able to prove a reasonable prospect of recoupment of predatory losses through supra-competitive pricing by a disciplined oligopoly. App. 6a.

The case then returned to the district court for further proceedings on the Robinson-Patman claim alone. After additional discovery, ARCO moved for summary judgment on the grounds that (i) there was no evidence of below-cost pricing by ARCO and (ii) there was no evidence of a "reasonable prospect" of recoupment of losses through oligopolistic means, even if below-cost pricing could be shown.[2] The district court granted summary judgment on the issue of below-cost pricing. R. App. 27a.

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[2] Both elements are required for a primary-line price-discrimination case. *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 222, 224, 113 S. Ct. 2578, 2587-88, *reh'g denied*, 509 U.S. 940, 114 S. Ct. 13 (1993).

On appeal, the court below affirmed the decision of the district court that petitioners had failed to present evidence of below-cost pricing.[3] App. 22a. The petition seeks review of that decision.

As more fully described herein, the court below did not reject "objective" measures of ARCO's cost, or impose "insuperable obstacles" on petitioners. Pet. 2-3. Nor do the other argumentative characterizations of the opinions below constitute accurate statements of the courts' reasoning or of the record. The petition includes numerous purportedly factual assertions, namely the claims that ARCO's prices in Las Vegas "uniformly undercut" its Los Angeles prices during 1986-89, that 37 firms, including five major oil companies, "fled" the Las Vegas market during that period; that ARCO achieved a market share "unprecedented" in the U.S. petroleum industry; and that during 1990-91 ARCO's Las Vegas prices "consistently exceeded" its Los Angeles prices (Pet. 3), which are as erroneous as they are irrelevant. The record affirmatively shows that petitioners' market-share calculations were unsupportable as a matter of law. App. 31a-32a. Similarly, petitioners' claims regarding market exit did not count market *entry* during the same period, or include *increases* in non-ARCO gasoline sales and sales capacity in Las Vegas, including the expansion of petitioners' own sales volume (and profits). Undisputed evidence refuted petitioners' insistence that ARCO's wholesale prices in Las Vegas were outside the range of its wholesale prices in the Los Angeles area, with the exception of two brief periods attributable to (i) a retail price war in Las Vegas (initiated by petitioners and another independent marketer), and (ii) worldwide price shocks following Iraq's

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[3] The court below found it unnecessary to consider whether, on the more developed record, there was any evidence of a reasonable prospect of recoupment through oligopolistic means. App. 22a (footnote 2).

invasion of Kuwait, and the resulting Persian Gulf War, in 1990-91.

REASONS FOR DENYING THE WRIT

As recently as 1993, this Court again "rejected . . . the notion that above-cost prices that are below general market levels or the costs of a firm's competitors" are actionable under the antitrust laws, *Brooke Group, Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. at 223, 113 S. Ct. at 2588. Yet, that is the very notion that petitioners now ask this Court to adopt. Petitioners' purported methods of proving that ARCO's prices were below cost were based on market prices, rather than on any of ARCO's production costs. Petitioners' argument that certiorari should be granted "to define the 'appropriate measure' of cost to be used in predatory pricing actions" (Pet. 7) fails at the outset, because none of petitioners' evidence actually measured ARCO's *cost* to produce and sell gasoline.

Instead, petitioners relied on general market levels or prices. App. 15a, 17a. Such market-based prices cannot be converted into costs simply by calling them "opportunity costs." No circuit court or any other authority supports the use of such opportunity costs as a substitute for production costs in evaluating below-cost pricing claims. The only lower court opinion cited in the petition predates *Brooke Group* and dealt with the entirely different issue of whether a calculation of average total cost must include a "minimum profit." *Infra* at 13. There is simply no conflict among the circuits on this issue—and petitioners' theory that ARCO's cost must be "equal to [the] exchangeable value" of its crude oil (Pet. 10) runs counter to this Court's rule that below-cost pricing cannot be proved by reference to "general market levels."

The attempt by petitioners to blame ARCO for their failure to offer any evidence of ARCO's actual produc-

tion cost is meritless. Petitioners' failure to offer proof of ARCO's costs provides no reason for this Court to depart from its prior rulings nor any reason why this Court should grant certiorari in this case. While ARCO did not have a pre-packaged cost calculation on which petitioners could rely without effort, petitioners' expert admitted that cost calculations for a single product are "problematic" when the product is only one of several outputs of a unitary manufacturing process, as when a barrel of crude oil is refined into gasoline, diesel fuel, heating oil and myriad other products. R. App. 21a.[4] Petitioners elected not to take any discovery concerning ARCO's raw-material and manufacturing costs, and thus did not even attempt to allocate those costs. Petitioners did not do so because they knew that ARCO was "a low cost producer of crude" (App. 16a), so that ARCO's prices for its entire slate of refined petroleum products more than covered its costs by any measure. The record shows that:

> Rebel's expert, Dr. Leffler, admitted that "it's accepted that *ARCO was a low cost producer of crude in this era* so, if anything, I would expect it [ARCO] to have a lower cost than what was reflected in the market value of that barrel." . . . Aside from this admission that ARCO's cost of producing the crude oil was low, *Rebel presented no evidence of the actual costs of production.* Nevertheless, Leffler argued for the use of market price as a measure of ARCO's cost . . . .

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[4] It was undisputed that the joint-cost aspects of petroleum-product production render a determination of average variable costs, for gasoline alone, "problematic." R. App. 21a. Respected commentators have observed that where the manufacturing costs of multiple products are jointly incurred, "it may not be practically feasible to determine the respective marginal costs." III P. Areeda & H. Hovencamp, *Antitrust Law* 415, ¶ 742c (Rev. Ed. 1996). This practical infeasibility does not, however, preclude a cost-based test for predation, since predation can be tested "by comparing the combined prices of the several products with their aggregate marginal costs." *Id.*

App. 16a (citations omitted; emphasis added).[5] The only insuperable obstacles faced by petitioners were inherent in that decision and their consequent attempt to prove that ARCO had sold gasoline below cost by showing, instead, that ARCO's prices were below market prices. App. 15a-18a.

Similarly unpersuasive is petitioners' argument that a refusal to rely on market-price averages as a measure of production cost will "undermine" antitrust enforcement. Pet. 16-20. Nothing could be further from the truth. Far from promoting the "primary concern of antitrust law" —consumer welfare—petitioners' argument that a price may be below "cost" simply because the product could have been sold at a higher price (since the higher price defines the "opportunity cost" of the foregone alternative), *even if that price more than covers the expenses actually incurred in the manufacturing and marketing process,* would stand the antitrust laws on their head. Petitioners' argument, if adopted, would establish prevailing prices as a "floor" below which any competitor could not lower its price, without fear of a predatory pricing claim.

This Court has frequently championed the consumer-welfare values of the antitrust laws, and cautioned against their use to chill legitimate price competition for the benefit of less-efficient competitors. "[C]utting prices in order to increase business often is the very essence of competition." *Matsushita Electric Industrial Co., Ltd. v.*

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[5] The district court likewise found:

> [L]effler stated that he believed that refinery computer simulation models which measure marginal cost in the traditional economic methodology were available to all refiners . . . . However, Leffler *did not utilize this method,* since he did not have the proper knowledge, or "have access to people at ARCO." . . . *Rebel has made no showing that it ever attempted to obtain such information* . . . .

R. App. 21a (citations omitted; emphasis added).

Zenith Radio Corp., 475 U.S. 574, 594, 106 S. Ct. 1348, 1360 (1986); *see Cargill, Inc. v. Montfort of Colorado, Inc.*, 479 U.S. 104, 122 n.17, 107 S. Ct. 484, 495 n.17 (1986) ("lowering prices . . . is the same method by which a firm stimulates competition"); *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 340, 110 S. Ct. 1884, 1892 ("Low prices benefit consumers regardless of how those prices are set . . ."); *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 724, 108 S. Ct. 1515, 1519 (1988) (interbrand competition leads to lower prices to consumers and for that reason is "the primary concern of antitrust law"). To substitute an estimate of foregone revenue for a firm's actual costs of production, as petitioners propose, would greatly restrict "competition on the merits," *Brooke Group*, 509 U.S. at 223, 113 S. Ct. at 2588, "chill[ing] the very conduct the antitrust laws were designed to protect." *Matsushita*, 475 U.S. at 594, 106 S. Ct. at 1360; *see Brooke Group*, 509 U.S. at 223, 113 S. Ct. at 2588 (warning of limits on the "practical ability of a judicial tribunal" to control prices "without courting intolerable risks of chilling legitimate price-cutting"); *Business Electronics*, 485 U.S. at 728, 110 S. Ct. at 1521 (warning against rules that cause "manufacturers to forego legitimate and competitively useful conduct rather than risk treble damages and perhaps even criminal penalties").

I. PETITIONERS DID NOT OFFER "OBJECTIVE" MEASURES OF ARCO'S GASOLINE-PRODUCTION COST.

The petition asserts that the court below wrongly rejected "three objective measures of ARCO's marginal cost of gasoline," thereby presenting for this Court an issue of defining the appropriate measure of cost to be used in a predatory-pricing case. Pet. 3. In truth, the court did no such thing, but instead applied this Court's direction not to define as predatory prices that are merely below general market levels.

A. The ARCO/Tosco exchange agreement.

Petitioners assert that the court below rejected an objective measure of ARCO's cost, based on "the *market value* of the crude oil that ARCO traded to [Tosco] to obtain incremental supplies of gasoline." Pet. 3-4 (emphasis added). However, market values do not measure cost.

The court below fully examined the contention that the exchange agreement between ARCO and another refiner, Tosco Corporation ("Tosco"), could be used as a yardstick to measure ARCO's marginal cost of gasoline production. App. 13a-17a. Under that agreement, ARCO delivered Alaska North Slope (ANS) crude oil to Tosco in a specified quantity in exchange for a specified quantity of gasoline from Tosco. App. 13a. The parties used invoices and cash payments only for security purposes, expressly intending that the dollar amounts paid by ARCO to Tosco, when picking up gasoline, would equal the dollar amounts paid by Tosco to ARCO when crude was delivered. App. 13a. The essence of the transaction, as admitted by petitioners' expert, was that crude oil was being exchanged for gasoline in a predetermined ratio, irrespective of market fluctuations. App. 14a-15a.[6]

As noted above (*supra*, at 5-6), petitioners recognized that ARCO's cost to produce the crude oil was low in relation to the selling price for the equivalent quantities of gasoline (even assuming that the gasoline had been sold in Las Vegas). However, petitioners asked the lower court to consider that ARCO could have more profitably sold the crude oil on the open market, rather than tendering it to Tosco as agreed. App. 15a. The court below declined to adopt that reasoning. App. 17a. In doing so, the court did not reject an "objective measure" of

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[6] The agreement was for a 10-year term and did not allow ARCO to vary the level of its crude deliveries or to reject tenders of gasoline by Tosco.

ARCO's gasoline-production cost, but rather rejected petitioners' notion that ARCO's cost could be measured by the market values of the exchanged product, even though petitioners admitted that ARCO was able to produce that product (crude oil) for substantially *less* than the market values. App. 16a.

The petition erroneously states that in rejecting petitioners' use of the Tosco agreement as a measure of ARCO's cost, the court below rejected the analysis of the Areeda and Hovencamp treatise. Pet. 2. That is simply not true.

In their treatise, a portion of which is reprinted in the Appendix (App. 89a), Professors Areeda and Hovencamp described the Ninth Circuit's prior opinion in this case, *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421 (9th Cir.), *cert. denied*, 516 U.S. 987, 116 S. Ct. 515 (1995), as involving allegations that ARCO had purchased additional supplies of gasoline from another refiner, and had then sold the gasoline in Las Vegas for less than the purchase price. *Id.* The commentators concluded, "If so, the resulting price was clearly below marginal cost." *Id.*

While that is what petitioners had *alleged*, it is not at all what they ultimately were able to prove. After the case had been remanded to the district court, petitioners' expert admitted that ARCO had not purchased gasoline from the other refiner, as petitioners had previously claimed, but had *exchanged* crude oil for the gasoline. App. 15a. At that point, it was clear that the "[i]f so" assumption was not correct, and that therefore there was no basis for concluding that ARCO's prices were below marginal cost.

Based on the undisputed evidence that ARCO acquired the gasoline in a crude oil-for-gasoline exchange, the court below recognized that the cost of the product being obtained (gasoline) must be determined by the cost of the

product (crude oil) being tendered in exchange. App. 16a. The court thus rejected the opinion of petitioners' expert, who used the market value of the crude oil, rather than the incremental production cost, as the measure of ARCO's cost to acquire the gasoline. Nothing in Areeda and Hovencamp's *Antitrust Law* contradicts that conclusion.

B. Los Angeles "rack price" averages.

Petitioners' second allegedly objective measure of ARCO's cost was an even more naked attempt to tie ARCO's prices to "general market levels," specifically, the prices charged by ARCO's competitors. Petitioners claimed that ARCO's prices were "below cost" because they were below an arithmetic average of the posted prices of other wholesale gasoline suppliers (of tanker-truck quantities) in Los. Angeles. App. 17a.[7] The court below observed that the use of an average of prices in another market "would substitute market price for ARCO's actual costs" and correctly rejected the use of such averages on that basis. App. 18a.

C. Profitability of individual retail stores operated by ARCO.

Finally, the petition states that the court below refused consideration of profit-and-loss statements for individual

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[7] Wholesale sales in tanker-truck quantities are known as "rack sales," since the deliveries are made at a "loading rack." Petitioners chose that high-priced market (in which ARCO dooes not sell) as a measure of ARCO's cost even though lower-priced markets, such as the market for gasoline in pipeline-tender quantities, had been used as the reference point. However, the theory was flawed from the beginning; whatever wisdom there may be in the microeconomic theorem that a firm will continue to produce output until its marginal cost rises to equal marginal revenue, petitioners are unable to cite any reputable economist in support of the claim (rejected by the court below) that any firm's cost can therefore be measured by the average price for that product, *as charged by the firm's competitors*, in any market.

retail stations operated by ARCO's wholly-owned subsidiary, Prestige Stations, Inc. Pet. 4-5. In fact, the only evidence on that topic was excluded by the district court in an order *in limine* from which petitioners never appealed. App. 18a. Nevertheless, both the district court and the court below observed that the financial statements were not probative of ARCO's production costs. App. 19a. In reaching that conclusion, the courts below relied on established law that the price charged by a parent to a wholly-owned subsidary is merely an internal transfer price and the subsidiary's profitability *vel non* is not indicative of whether the enterprise is operating profitably, taken as a whole. *Id.*

II. THERE IS NO CONFLICT: NO CIRCUIT COURT HAS USED "OPPORTUNITY COSTS" AS PETITIONERS CONTEND.

Petitioners contend that this Court's intervention is needed to define the proper measure of a defendant's "cost". Pet. 6. While it is true that this Court has not defined a single "appropriate measure" of cost in predatory-pricing cases, *see, e.g., Brooke Group,* 509 U.S. at 222 n.1, 113 S. Ct. at 2587 n.1 ("we again decline to resolve the conflict among the lower courts over the appropriate measure of cost"), the Court has removed any remaining doubt regarding whether *above*-cost prices, which merely shift market share from the plaintiff to the defendant, can ever be unlawful. *Brooke Group,* 509 U.S. at 223, 113 S. Ct. at 2588. The lower courts now recognize that non-predatory price-cutting, even if painful for competitors, is the essence of competition. *George Haug Co., Inc. v. Rolls Royce Motor Cars Inc.,* 148 F.3d 136, 141 n.2 (2d Cir. 1998); *Advo, Inc. v. Philadelphia Newspapers, Inc.,* 51 F.3d 1191, 1198 (3d Cir. 1995); *R. W. International Corp. v. Welch Food, Inc.,* 13 F.3d 478, 488 (1st Cir. 1994). There is nothing in this case that would even allow the Court to consider whether aver-

age variable cost, for example, may be used as *the* proxy for marginal cost. As described above, petitioners eschewed any cost calculations.

Petitioners further assert that there is a conflict among the circuits regarding whether "opportunity costs" are relevant to a determination of whether a defendant's sales are below cost. Pet. at 6 (citing "the split between federal circuits on the issue of opportunity costs specifically"). However, there are no lower court opinions that apply "opportunity cost" as petitioners would apply it here.[8] *A fortiori*, there is no conflict among the circuits. Extensive research has found only two other cases in which "opportunity costs" were urged as a measure of marginal cost in a predatory pricing case, *Continental Airlines, Inc. v. American Airlines, Inc.*, 824 F. Supp.

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[8] In economics, "opportunity cost" refers to the consequences of foregone alternatives. K. Case & L. Fair, *Principles of Microeconomics* (5th ed. 1999) at 2. As used by petitioners, opportunity cost refers to petitioners' proposed definition of ARCO's gasoline "cost" as the *market value* of the crude oil that ARCO gave to Tosco in exchange. According to petitioners' theory, it did not matter that ARCO sold its gasoline *for more than the cost incurred to produce the crude oil*. App. 16a. Rather, petitioners argued that ARCO's cost was equal to the revenue that ARCO forewent (its "opportunity cost") when ARCO delivered the crude oil pursuant to the Exchange Agreement, thereby failing to maximize the profit theoretically available to ARCO by selling the crude on the open market in breach of the contract. If petitioners' argument were accepted, a defendant's actual costs would become irrelevant; the plaintiff in a primary-line price-discrimination case (and, presumably, in an attempted-monopolization case under Section 2 of the Sherman Act as well) could prevail merely by showing that the defendant had another, higher-price outlet for its goods. The defendant's "cost" would equal the defendant's highest-price alternative (as determined in hindsight by the plaintiff's retained expert), even where the defendant's actual price exceeded actual production costs. That would have the paradoxical and repugnant effect of forbidding the type of above-cost price-cutting the antitrust laws were intended to encourage, and reinstate the now-discredited notion that above-cost prices that are below general market levels inflict injury to competition. *Supra* at 4-7.

689, 701 (S.D. Tex. 1993); *In re IBM Peripheral EDP Devices Antitrust Litigation,* 459 F. Supp. 626, 631 (N.D. Cal. 1978), both of which were cited by the court below (App. 15a-16a) and are in accord with its opinion. On the other hand, the case cited by petitioners as evidencing a conflict, *McGahee v. Northern Propane Gas Co.,* 858 F.2d 1487, 1500-01 (11th Cir. 1988), *cert. denied,* 490 U.S. 1084, 109 S. Ct. 2110 (1989) (Pet. 6, 12), did not equate "opportunity cost" with marginal cost as petitioners claim.

In *McGahee,* the Eleventh Circuit adopted a test for predation that used average total cost (ATC), rather than average variable cost (AVC), as the principal cost measure. *Id.* at 1502-04. *McGahee* mentioned the economic theory of opportunity costs in passing support of its conclusion that ATC must include a factor for "a fair profit" or a "minimum profit." *Id.* at 1500-01 & n.31. While *McGahee*'s inclusion of profit as a "cost" arguably runs counter to this Court's reasoning in *Brooke Group,* that does not make the present petition certworthy. The petition does not present the question of whether *McGahee*'s rulings regarding profit remain viable. The decision of the court below that petitioners could not prevail without evidence of ARCO's actual costs of production was squarely in accord with existing law and does not present any issue warranting intervention by this Court.

CONCLUSION

For the reasons stated, the petition should be denied.

Respectfully submitted,

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